

# **CONTRACTOR RISK MANAGEMENT**

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### **1. This Chapter is about:**

A. This chapter establishes the DCMC risk management policy and methodology used by a Contract Administration Office (CAO) to document a statement of risk and the extent of surveillance needed at a specific defense contractor facility. All DCMC CAO management, technical assessment and operations personnel will use a risk management approach that includes planning, assessing, handling, and monitoring DCMC surveillance activity. This chapter describes risk management, surveillance planning, the DLAD 5000.4 processes requiring surveillance plans, and the interrelationship of the Performance Based Assessment Model (PBAM) Users Guide.

B. The typical outputs for this process are:

- 1) Risk-based surveillance plans addressing applicable contract requirements at specific contractor locations
- 2) Performance Based Assessment Model (PBAM) contractor risk ratings

### **2. We do this because:**

A. This chapter enables DCMC CAO management, technical assessment groups, and functional specialists to assess the level of risk at a contractor facility. We are using a risk management approach to determine the priority, degree, intensity of surveillance, and resources needed at specific locations.

B. The chapter influences the DCMC top level metrics of Right Advice, Right Time, Right Price, Right Item, and Right Talent.

### **3. DCMC Policy:**

**A. CAO management, technical assessment groups and operations personnel shall use a risk management approach comprised of risk planning, risk assessment, risk handling, and risk monitoring to assess contractor conformance and define CAO actions.**

### **4. THE PROCESS AND WHO IS RESPONSIBLE:**

#### **A. Process Inputs:**

- 1) Contract, Purchase Order and Modifications
- 2) Memorandum of Agreement (MOA), Quality Assurance Letter of Instruction (QALI), Letter of Delegation (LoD)
- 3) Federal Acquisition Regulation/Defense Acquisition Regulation Supplement
- 4) Performance Based Assessment Model (PBAM) Users Guide

- 5) Performance Based Business Environment (PBBE) Guidelines
- 6) Contractor policies, procedures, standards, and data (e.g., minutes, records of reviews and audits, results of inspections and tests, corrective actions, etc.)
- 7) Information obtained by attending formal/informal reviews
- 8) Customer feedback
- 9) Preaward Survey
- 10) DLAD 5000.4: (Functional chapters – Surveillance Plans)
  - a) 2.1.1 Systems Planning, Research, Development & Engineering
  - b) 2.1.2 Test and Evaluation Management
  - c) 2.1.3 Software Development Surveillance
  - d) 2.2.1.a Quality Assurance Surveillance
  - e) 2.2.1.b Production Management
  - f) 2.2.2 Packaging Management Program
  - g) 2.3.1 Configuration Management
  - h) 2.3.2 Parts Control Program
  - i) 2.3.3 Value Engineering
  - j) 2.3.4 Technical Data
  - k) 2.4.4 ILS
  - l) 3.1.2 Earned Value Management System
  - m) 4.5.2 Progress Payments Based on Costs
  - n) 4.5.3 Performance Based Payments
  - o) 4.7.3, Property Control System Analysis
- 11) DLAD 5000.4, 6.1.1, Contract Receipt, Review and Postaward

#### **B. Sub Processes**

- 1) Risk Planning
- 2) Risk Assessment
- 3) Risk Handling
- 4) Risk Monitoring

#### **C. Process Mechanisms:**

- 1) Functional personnel
- 2) Integrated Product Teams (IPTs) (as applicable)
- 3) Contractor documentation, products/processes, metrics and data
- 4) Supplier Information Service (SIS)
- 5) Process Oriented Contract Administration Services (PROCAS)
- 6) Inspection/audit results
- 7) Data analysis
- 8) Electronic tools

#### **D. Process Controls:**

- 1) Contractual Terms and Conditions
- 2) Customer requirements
- 3) CAO management review

- 4) Unit self-assessment (USA)
- 5) Internal Operations Assessment (IOA)

**E. Process Flowchart:** Refer to Process Flowchart Diagram

**F. Who does what and when they do it:**

**1) Risk Planning**

**a. CAO operations teams or functional specialists shall review the contract/modifications along with any other customer guidance to gain a clear understanding of customer needs and expectations. ([Chapter 6.1.1, Contract Receipt, Review and Postaward](#))(hotlink). The purpose of the review is to identify the contractor systems and key processes that have the potential to impact performance, schedule or cost factors. The output of the review shall be used to develop and implement surveillance plans. As a minimum, surveillance plans shall address:**

- I. Reviewing contract/customer requirements**
  - II. Identifying systems, key processes and/or key product characteristics**
  - III. Assigning risk ratings associated with systems, key processes and/or key product characteristics and documenting rationale**
  - IV. Using the PBAM risk assessment as an input to surveillance plans, as applicable**
  - V. Selecting/documenting surveillance methods, e.g., product audits, process proofing, system evaluations, data analysis, etc. to mitigate risk**
  - VI. Systematically tracking and evaluating the surveillance actions**
  - VII. Analyzing data to effect continuous improvement**
  - VIII. Adjusting surveillance and updating the PBAM risk assessment, as applicable**
- b. DCMC CAO management or technical assessment group shall apply the PBAM risk management tool as specified in the [PBAM Users Guide](#)(hotlink). The PBAM tool facilitates the assessment and management of risk presented to the DCMC CAO at a given contractor location.**

## **2) Risk Assessment**

**a. The functional specialist shall assign a risk rating to each system or key process that is likely to significantly affect contract performance, schedule or cost objectives.** The risk ratings are based on probability of occurrence and consequence and are a measure of the contractor's experience and performance, as related to the capability of their systems and key processes to meet contract requirements. **Key process risk ratings shall be supported by data, i.e., product audits, process proofings, system evaluations and Government/contractor performance data.** Each system or key process shall be classified in one of the following risk ratings:

**I. High Risk(3): Performance data casts significant doubt on the system or key process ability to meet requirements. A major disruption is probable and the likelihood is the contractor will not achieve the performance, schedule or cost objectives.**

**II. Moderate Risk(2): Performance data is insufficient on the system or key processes. Some disruption may occur, or it is probable the contractor will encounter delays in meeting the performance, schedule or cost objectives.**

**III. Low Risk(1): Performance data provides confidence in effectiveness and efficiency of the system or key process. Minimal or no impact will occur in meeting performance, schedule or cost objectives.**

**b. Using the PBAM application criteria, DCMC CAO management or Technical Assessment Groups (TAGs) shall assess contractor end item performance, schedule and cost. An overall contractor risk rating shall be assigned. The risk rating is a composite of ratings assigned to the applicable 42 key elements within the PBAM. When the DCMC CAO establishes an overall PBAM risk rating for a contractor, the applicable key elements and levels of risk shall serve as an input to the development of a surveillance plan.**

## **3) Risk Handling**

**a. Operational teams or functional specialists shall use surveillance plans (risk handling plans) or an optional surveillance method ([Contractor Self-Oversight, Attachment 1](#)) ([hotlink](#)) as the DCMC operational risk management tool. The surveillance plan (risk handling plan) shall be used to mitigate risk associated with systems and key processes that support the accomplishment of contract terms and conditions. The plan objective is to ensure contract requirements are met and to effect continuous improvement in contractor performance, schedule and cost.**

**b. Using risk planning results, surveillance plans (risk handling plans) shall be developed and executed using an [Integrated Product Team \(IPT\)\(hotlink\)](#) approach when more than one functional skill is needed to perform surveillance functions. Specific surveillance plans shall be developed and executed for the following DLAD 5000.4 processes:**

[I. 2.1.1 Systems Planning, Research, Development & Engineering\(hotlinks\)](#)

[II. 2.1.2 Test and Evaluation Management](#)

[III. 2.1.3 Software Development Surveillance](#)

[IV. 2.2.1.a Quality Assurance Surveillance](#)

[V. 2.2.1.a Production Management Surveillance](#)

[VI. 2.2.2 Packaging Management Program](#)

[VII. 2.3.1 Configuration Management](#)

[VIII. 2.3.2 Parts Control Program](#)

[IX. 2.3.3 Value Engineering](#)

[X. 2.3.4 Technical Data](#)

[XI. 2.4.4 ILS](#)

[XII. 3.1.2 Earned Value Management System](#)

[XIII. 4.5.2 Progress Payments Based on Costs](#)

[XIV.4.5.3 Performance Based Payments](#)

[XV.4.7.3 Property Control and System Analysis](#)

**c. Surveillance plans (risk handling plans) shall address each contractor at any given location regardless of the complexity or simplicity of the acquisition. Small dollar or low risk contractors are not excluded from the requirement of a surveillance plan. Integration of functional relationships shall be an essential aspect of surveillance plans (risk handling plans) when more than one functional area is surveilled.**

**d. Maximum flexibility shall be used in tailoring surveillance plans (risk handling plans) to the differing work and operating environments, i.e., program managed, individual contracts, or contractor facility. Geographic CAOs may use surveillance plan templates to address multiple contractors providing the templates are tailored to describe the specific systems, key processes, and/or key product characteristics unique to each contractor.**

**e. The operations team shall ensure surveillance plan (risk handling plan) key process risk ratings are available to management and technical assessment groups, and used to maintain or adjust applicable PBAM risk ratings.**

#### 4) Risk Monitoring

**a. The surveillance plan (risk handling plan) shall document the method, intensity, schedule/frequency and who is responsible for accomplishing the tasks in the risk area.** Some examples of different risk handling methods for systems or key processes are outlined below. Appropriate PROCAS methods can be used for any of these risk ratings to achieve improvements in systems, processes or products.

- I. High Risk: Immediate and intensive surveillance should occur. These actions may include establishment of intensive system evaluations, product audits, partial or full process proofing, data review, root cause analysis, and corrective action, statistical sampling, etc.
- II. Moderate Risk: Intensity and frequency of surveillance may include establishment of scheduled system evaluations, process or product audits, partial or full process proofing, data review, root cause analysis, and corrective action, statistical sampling, etc.
- III. Low Risk: Intensity and frequency of surveillance may be minimal using periodic reviews of Government and contractor data (e.g., EVMS, delivery performance history, process control data, cost control data, extensive audit data).

**b. The operations team or functional specialists shall track, evaluate, and document the contractor performance relating to systems and key processes within the surveillance plan (risk handling plan). Surveillance activities shall be tracked against results to determine if objectives are being met or new surveillance methods are needed.**

**c. The operations team or functional specialist is expected to vary surveillance methods, intensity, and frequency based on the performance of contractor systems and key processes. Adverse performance data shall result in corrective action measures and an increase in the intensity of surveillance (e.g. frequency, product audits) until corrective actions are finalized. Trend analysis of system and process performance indicating low risk, shall result in a decrease in surveillance (e.g. frequency, data analysis, alternate surveillance). The risk monitoring data analysis results shall be used to update/modify the applicable PBAM element ratings.**

#### 5. Additional process information:

- A. DCMC Business Plan
- B. DCMC Metrics Guidebook
- C. AMS Process Improvement Network (PIN)
- D. IOA Findings
- E. Function-specific chapters.

- 6. Competencies and certifications required to execute this process:** See function-specific chapters.
- 7. PLAS codes for this process:** See function-specific chapters
- 8. The DCMC Headquarters/District points of contact:** See function-specific chapters.

## ATTACHMENT 1 Contractor Self-Oversight (CSO)

1. Contractor Self-Oversight (CSO) is an alternative means of accomplishing the surveillance tasks related to Government Property, Delivery, and Quality Assurance. Under CSO, the normal Government surveillance is performed by contractor personnel. CSO may be applied to a single contractor process, multiple processes, or all tasks outlined in the surveillance plan applicable to Government Property, Delivery and Quality Assurance. **CSO shall not include formal acceptance (e.g., execution of the DD Form 250) or surveillance of flight critical/safety of flight characteristics.**
2. The CSO tool shall only be used when the CAO and the customer(s) have confidence in a contractor's ability to provide the necessary surveillance. The CSO method enables a measurable reduction of direct DCMC in-plant surveillance and no cost increase for the Government is expected to result.
3. CAOs may elect to use CSO in lieu of direct DCMC oversight only when all of the following conditions are met:
  - a. The CAO, contractor, and all affected customers (including the buying, Program Management, and Systems Program Offices, as applicable) agree to use CSO. [Management Councils](#) are the correct forum for review and consideration of CSO proposals. DCMC personnel assigned responsibility for surveillance are responsible for reviewing and determining the adequacy of the contractor's self-oversight plan and for coordinating the plan with the Management Council. However, final approval of CSO should be reserved to the Government.
  - b. The Government and the contractor execute a memorandum of agreement (MOA) that is reviewed by legal counsel, and as a minimum contains the following:
    - c. Identification and schedule of the surveillance or oversight tasks to be performed by the contractor.
    - d. Identification of the contractor personnel who will perform the surveillance tasks and their qualifications.
    - e. Agreement regarding performance standards that must be met to continue participation in CSO. The CAO may, in coordination with the customer, unilaterally discontinue CSO if there is poor performance by the contractor.
  - f. Details regarding how the CAO and the contractor will interact on CSO activities.
  - g. Identification of records created, maintained, and dispositioned.



- h. Language addressing how both parties can pursue changes/withdraw from the MOA.
- i. An expiration date not to exceed one year, at which time the MOA may be renewed.
- j. The MOA shall contain a statement that:

***“The parties acknowledge and understand that this CSO agreement does not modify or change the terms and conditions of any contract(s). This CSO agreement shall not be used to alter, supplement, or deviate from the terms and conditions of the contract(s) and the legal rights and obligations of the parties set forth in those contracts. Any change to the contract(s) must be executed in writing by the Contracting Officer.”***

4. The CAO surveillance plans shall be modified to indicate which processes, surveillance task or functions will be subject to CSO, and how the CAO will monitor contractor activities to ensure they are providing the necessary assurance of contract compliance, e.g. periodic reviews of work products, analysis of contractor audits, etc

## GLOSSARY

**Critical Characteristics:** Some documents use the term critical characteristics. Critical characteristics can be considered key characteristics which focus on personnel safety and mission performance. A nonconformance in a critical characteristic is likely to result in a hazardous or unsafe condition for personnel using, maintaining, or depending on the product. A nonconformance may also prevent the performance of an important function of a major end item.

**Critical Processes:** Some documents use the term critical processes. Critical processes are key processes that are used to meet critical product characteristic requirements. Properly controlled critical processes ensure personnel safety and mission performance. Critical processes can be derived from critical product characteristics.

**Key Characteristics:** Those features of a material or part whose variation has a significant influence on product fit, performance, service life, or manufacturability.

**Key Elements:** A set/subset of 42 PBAM elements related to performance, schedule and cost.

**Key Processes:** Those processes which, if not properly controlled, can have a significantly adverse effect on contract performance, cost, or schedule requirements.

**Key Processes (Supporting Top Level Systems):** The top level systems referred to in contract requirements (e.g., Configuration Management; Quality Management; Earned Value; Government Property; Subcontract Management; Software Management; etc.) are supported by key processes such as: Production Planning and Control; Measuring & Test Equipment; Engineering Drawing Release; Demilitarization; Packaging; Vendor Rating; etc.

**Key Processes (Supporting key product characteristics):** The key lower level supporting and enabling processes can derive directly from the key product characteristics, and are used to produce these characteristics. Control of these characteristics can ensure a product will meet its technical requirements. These characteristics are specific features of the design that are most important to control during manufacture and test. Every process has an output, or a product. Key product elements, features, or characteristics, are those which can have a significant influence on the product's use or ability to meet its contract, performance, cost, or schedule requirements. These characteristics should be measurable and will highlight what process areas should be the focus of control efforts (and variability reduction efforts in the case of engineering and manufacturing).

**PBAM Users Guide:** A DCMC CAO management or technical assessment group tool used to assess risk at a specific contractor location and to tailor functional oversight. The PBAM tool evaluates 42 contractor system key elements related to performance, schedule and cost. The applicable guide key elements are assessed using : inherent product/process characteristics and contractor performance attributes past/future. The PBAM risk assessment process includes: identifying the applicable inherent product/process characteristics; analyzing contractor and Government data; determining a contractor roll-up risk rating; and documenting all stages of the process.

**Risk:** A measure of the potential inability to achieve overall program objectives within defined cost, schedule, and technical constraints and has two components: the probability of failing to achieve a particular outcome and consequence of failing to achieve that outcome.

**Risk Management:** The act or practice of dealing with risk. It includes planning, assessing, handling, monitoring, and adjusting risk handling options as the risks/risk ratings change.

**Risk Planning:** The process of developing and documenting an organized, comprehensive, and interactive strategy and methods for carrying out risk management, which includes assigning adequate resources.

**Risk Assessment:** The process of identifying and analyzing program areas and critical technical process risks to increase the likelihood of meeting performance, schedule, and cost objectives.

**Risk Handling:** The process that identifies, evaluates, selects, and implements options in order to set risk at acceptable levels given program constraints and objectives.

**Risk Monitoring:** The process that systematically tracks and evaluates the performance of risk-handling actions against established metrics. The process includes changing risk handling options to match changes in risk ratings or employing new risk handling options if current ones are ineffective.

**Surveillance plan (risk handling plan):** A surveillance plan describes an operations team or functional specialist risk-based approach for performing functional surveillance at a contractor facility. The sophistication and length of the plan is contingent on the volume of business at a contractor facility or the complexity of a specific acquisition. Typically a program managed contract with a supporting memorandum of agreement will require a more sophisticated, lengthy plan than a small contractor with intermittent business. A functional surveillance plan can be a standalone plan that covers a single process, be an integrated plan that covers more than one functional area, and/or be part of an integrated plan, such as a program plan. The level of detail, scope, and integration of functional plans shall vary depending on the size of the contractor and the acquisition complexity and product criticality. Surveillance may be performed on a contract specific basis, when the requirement is not applicable to all contracts within a contractor facility, or on a facility basis, when the system or key process is common to all contracts within the contractor facility. For a small contractor actions may be limited to validating schedule commitments and final inspection or testing, and may require minimum production and quality surveillance.